Foreign Asset Reserves Stagnate

Foreign asset reserves, also known as foreign exchange reserves, fell sharply a few years ago, especially in China and the emerging oil-producing countries. The level of reserves is now more stable, but there are no signs of an uptrend in the near future.

China has by far the largest foreign exchange reserves, while the country made efforts for several years to undervalue its currency to maintain a trade surplus. The sharp rise in the greenback’s value since mid-2014 has lowered the need to artificially maintain a weak yuan, however. The subsequent slowdown in China’s growth and various concerns, including heavily indebted Chinese companies and U.S. protectionism, prompted the monetary authorities to support the yuan by selling reserves on occasion. Oil-producing countries stockpile reserves when the prices for this resource are high and these reserves are tapped into when the market slumps, as has been the case in the past few years. We do not anticipate a strong improvement on this front.

Switzerland now ranks third for the size of its foreign exchange reserves. The country has been stockpiling reserves to prevent the Swiss franc from rising against the euro. This helped offset the period when the reserves in China and in the oil-producing countries started to dwindle. The fact that the euro has been doing better since the middle of 2017 has reduced the need for the Swiss monetary authorities to intervene. The recent drop in the euro may nevertheless be consistent with further rise in reserves, but this may only be fleeting.

IMPLICATIONS

The period when foreign exchange reserves were heavily stockpiled appears to be well over. And since these reserves hold a large quantity of U.S. Treasury securities, new opportunities have to be found. U.S. households especially increased their holdings of U.S. Treasuries in 2018. Rising bond yields likely helped with this adjustment. In addition to encouraging savings, they discourage private sector debt and free up more financial resources for the public sector.